DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

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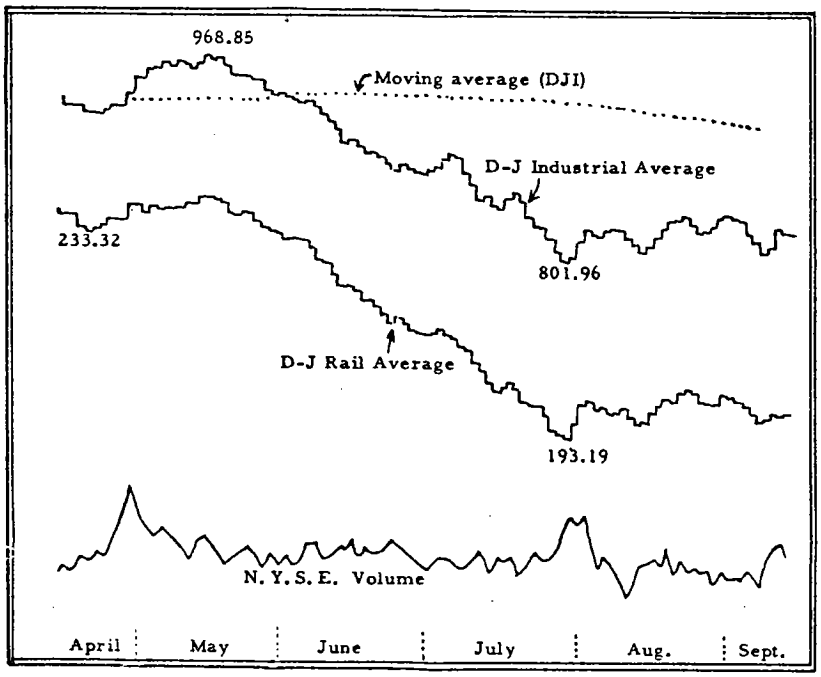
THE MARKET: Bear markets are made to separate investors and speculators from their money. Sometimes this process occurs in one fell swoop, as in the 1937 smash, sometimes it is a long, drawn-out procedure as the 1946-1949 period, and sometimes it is a series of violent rallies and collapses as during 1929 to 1932.

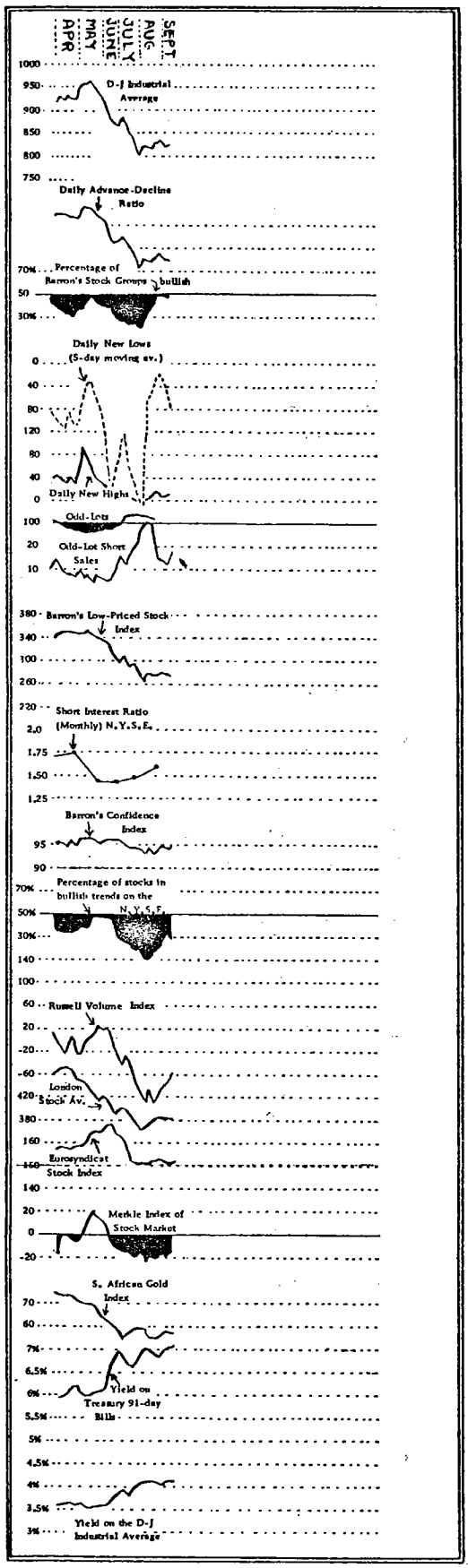
This bear market, it seems to me, promises to be particularly vicious and thorough. Speculative low-priced stocks (via the Amex) have started to collapse, many blue-chips are now selling at half their bull market highs, bonds, preferred stocks, all classes of equities and debt instruments have begun their baptism of fire.

I was particularly interested in an article in last week's authoritative Weekly Bond Buyer, pointing to the damage to that formerly most sophisticated instrument, the convertible bond. Here was a security which was supposed to enjoy the best of both possible worlds. In good markets the convertible would rise with the stock into which it was convertible, and during bad markets the convertible bond would tend to hold because investors would view it as a bond. Alas, in the atmosphere of declining stocks and rising interest rates (the latter bearish for bonds) the convertibles, many of which sold for fancy premiums, suffered the ills of both the stock and the bond market.

"Notwithstanding their.....built-in features," stated the Bond Buyer, "convertibles have followed a dismaying course so far this year, faring worse, as a group, than any other class of securities.....No one in the Street expects any kind of investing instrument to make a plus out of two minuses, but in the environment of lower stocks and bond markets, convertible debentures by and large have behaved like the creation of a mad scientist and displayed synergistic reaction to the two adverse influences."

By the way, many of my subscribers may wonder why I write so frequently about the bond market. I write about it because that is where the money is, and in size the bond market dwarfs the stock market. Losses and gains in the bond market affect

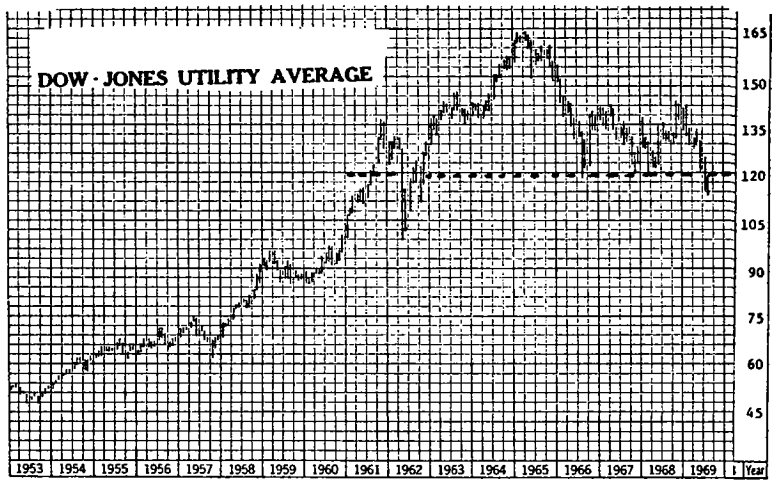




 the nation every bit as much as do fluctuations in the stock market. Look at these figures: during the first five months of 1969 corporations alone (I'm not talking about states, cities, municipalities, or the Federal Government) sold $5.2 billions of straight bonds and $2.2 billions of convertible bonds. During the same five months corporations sold $2.5 billions in common stock.

This may give subscribers some idea of where new money for financing and expansion comes from and the relative importance of the stock and bond markets. It may give subscribers some idea of the meaning of new lows in the bond market, and it may give subscribers a glimpse into the size of the paper losses incurred when the bond market declines. I might add (see chart on page 3, Letter 437) that on September 9 the pressure on the money markets again became dramatically visible as the D-J Utility stock dropped to its lowest level since 1962 while the 40-Bond Average sank to its lowest level since 1933.

In order to show the seriousness of the technical position of the Utility Average, I have included a long-term (monthly) chart of Utilities covering the period of 1953 to date. Having fallen off the 120 ledge, there is now nothing under the Utilities down to the 103.11 low of 1962. I would expect that any penetration of the 1962 low would be accompanied by the most drastic and chaotic conditions in the money markets. (Utility chart courtesy of M.C. Horsey, Salisbury, Md. 21801).



To turn to the stock market, it's difficult to say anything decisive when the Averages are fluctuating between recent lows and minor highs. In all, however, the market appears to be a rickety affair. Last week Barron's Low Priced Stock Index closed at 268.1, only points above the 1969 (July 29) low of 266.4. This implies to me that speculation is gradually waning, and it more or less confirms the generally lower volume which has accompanied the advance since the July lows.

The Industrial and Rail Averages are ratherlistless, seeming to "float" aimlessly except when some spot news sends Industrials up or down 5 to 10 points in a day. Aside from news stimulus, there seems no real conviction for either the rise or the decline.

Therefore, I lean on the orthodox principle that when a rally in a bear market becomes dull, distribution is taking place. My guess is that the next major move will be down through the 1969 lows, but this could take weeks or even until the end of the year. In the meantime, I would expect this market to be a treacherous affair with little broad interest and mostly individual stock or group action as rumors (always good for distribution) serve to stir up pockets of speculation within the framework of a primary bear market. Advice: Stay out of this market, short term scalping operations will cost you money on average. A primary bear market is difficult if not impossible to "beat".

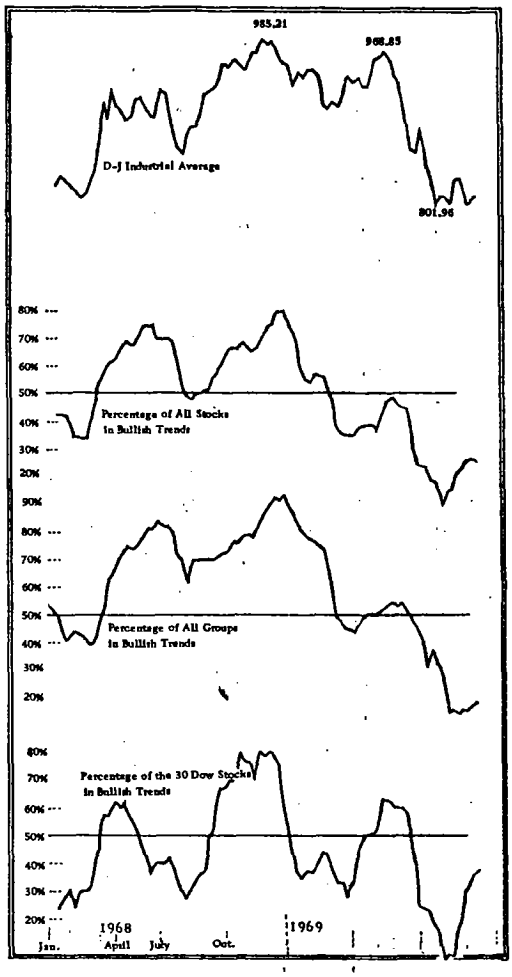
TECHNICAL PICTURE: The accompanying chart (page 3) provides a profile of the internal condition of the market. The chart shows the weekly closing of the D-J Industrial Average superimposed upon graphs of the percentage of all N.Y.S.E. in bullish trends, the percentage of the 89 Standard & Poor stock groups in bullish trends and finally the percentage of the 30 D-J Industrial stocks in bullish trends (all statistics from Chartcraft, Larchmont, N.Y.).

During a primary bull market the three percentage graphs tend to stay above the critical 50% level except during the most severe downward corrections. Conversely, during a primary bear market the three percentage graphs tend to stay below the 50% level except during the strongest upward corrections.

Looking at the 1968 area, we can see that the powerful upward correction (within the continuing bear market) took all three percentage graphs well above the 50% level. In fact, at the peak of strength, during December, 1968, the all-stock percentage reached 80%, the all-group percentage reached 93% and the Dow-stock percentage reached 80%. From December, 1968, the internal strength of the market began decomposing.

During the first quarter of 1969 all three bullish percentages dropped below the 50% level. Now here is the significant factor. On the rally into May, 1969, the Dow reached a high closing of 968.85, and this was within 17 points of the December, 1968 peak of 985.21. But look at the bullish percentages during the recovery to the May, 1969 highs. The bull percentage of all stocks reached 48%, 2% short of the 50% level. The bullish percentage of all groups reached 54%, slightly above the critical 50% level. And the bullish percentage of the 30 Dow stocks reached 64% which was above the 50% level but far below the 80% reached during December, 1968 (when the Dow was only 17 points higher).

Following the May, 1969 highs, the Dow Industrials turned down again, plunging to the July, 1969 low of 801.96. This time the three bullish percentage graphs plunged to percentage lows not seen since 1966.



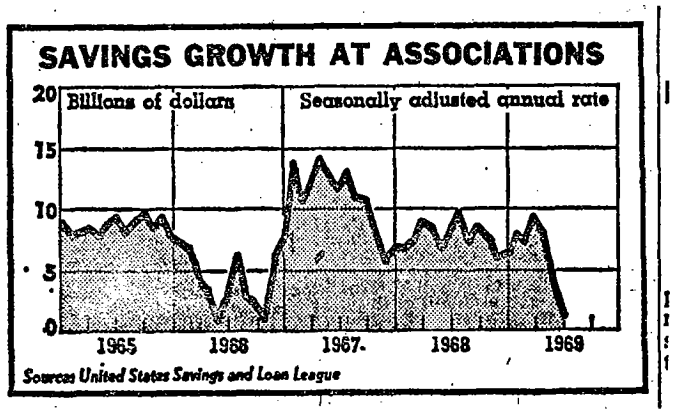
On the recent recovery from the July lows, the rise in the bullish percentage graphs was unimpressive. Two weeks ago the bullish percentage of all stocks reached 37%, then turned down. The bullish percentage of all groups hardly budged upwards, holding in the 14% area. And the bullish percentage of the 30 Dow stocks reached 35%, then declined.

From the standpoint of this bullish percentage study, the market turned weak in December, 1968, and it has remained weak during all rallies since. The most recent rally, starting at the end of July, was also unimpressive. Most lackluster of all has been the group bullish percentage which has hardly budged upward during the whole rally from the July low of 801.96 to the September 2 peak of 837.78. With almost no new groups turning bullish during the 36 point (five week) rally, the market can hardly be said to be in a strong position.

FLY IN THE OINTMENT: The "big-name" economist is the most quoted man around. Daily, the newspapers and magazines are loaded with the latest statements by Milton Friedman, Pierre Rinfret, Paul Samuelson, Paul McCracken and a host of others. In studying the statements of these gentlemen, one notes no end of variations. Some feel that the tight money policy of the Nixon Administration will fail to stop inflation or economic growth at all, others feel that some sort of recession will result, but they are not sure that even a recession will halt price inflation.

Great emphasis (via the Friedman school) is now placed on the money supply, rather than the older concept of interest rates alone in Federal Reserve policy. Last week the London Economist attempted to provide its readers with an insight into the American experiment. But somewhat confused, the Economist pointed out that there are 10 (yes, ten) definitions of the money supply, and much of the interpretation of what is occurring depends on what definition you happen to accept. "Alas," sighed the Economist, "now that almost everyone seems to agree that quantities (of money) are important, it is quite impossible to know what quantity to look at."

In the wake of a still-discouraging barrage of price increases and inflationary forces, the Administration seems ready to move further on the anti-inflation road. Or, as Business Week (Sept. 6) put it, "By summer, with inflation speeding up, officials conceded that the cooling-off process might hurt a little. Now the Administration is prepared to inflict pain."



No one knows at what point the pressure on the system will hit, but slowly and inevitably the danger cracks are showing. They are showing in bank and corporate liquidity, they are showing in the decline in bank time deposits and the decline in savings & loan deposits, they are showing in the collapse of private housing construction and perhaps in the lag in new car sales.

I believe that all the big name (and small name) economists are making a fundamental error. They are overlooking the fact that they are not operating within the framework of a primary bull market. During a bull market downward pressure acts like a hand pushing down on an elastic band. As soon as the downward pressure is released, the band springs up again—and usually harder than ever. But during a bear market the fundamental elasticity is absent, and downward pressure will ultimately send the whole structure to its knees.

Within a few months to a year, I expect the continuing monetary and economic pressure to send the structure of the market reeling to lower levels. Once the 801.96 Industrial low of 1969 (together with the 193.19 Rail low) are penetrated, the market will head for the 1966 lows of 744.32 (Industrials) and 184.34 (Rails). A breaking of the 1966 lows will, in my opinion, set off panic in the market as an avalanche of selling erupts from Wall Street and all over the country.

At that time I believe the nation will first wake up to the possibility of depression as billions of dollars in values are sent smashing to worthlessness in the fury of panic-selling and perhaps the greatest downside volume ever seen on the Exchanges. The psychology of a crash is what the economists today are not prepared for, are not thinking about, and are not entering into their econometric models. But at rare intervals the stock market not only predicts but takes a hand in changing psychology. That drastic change in mass psychology, the change brought about by the whirlwind of an all-out bear market smash, is the "fly in the ointment," the unknown ingredient which I believe is going to upset the calculations of almost everyone studying the economy and the market today.

THE SQUEEZE: With new issues of bonds such as the Aa-rated Long Island Lighting issue (8.20% yield) going for record yields, with the stock market sloppy, with new restrictions on Eurodollars and Eurodollar rates at above 10%, with municipal bonds sagging and with the D-J 40-Bond Averages at its lowest level since 1934, the rush for money is intensifying. The banks haven't got it, the savings and loan associations haven't got it, and that leaves the short-term market.

I enclose this reduction of an advertisement placed in the New York Times by a leading N.Y. savings bank. It's a great ad, and it is obviously shooting for the little fellow's money, the money which might go into Treasury bills or other forms of short-term paper. Traditionally, the savings banks never wanted short-term money, they wanted long-term deposits, and only a few years ago they paid no interest on money withdrawn before the quarterly interest payments. But the times are a' changin'. This bank is looking for any kind of money at any kind of time period. HOWEVER, notice the one little problem. Dividends are at the rate of 4.75% yearly, compounded quarterly. To be blunt about it, 4.75% just isn't enough these days.

FACTS ABOUT SPECIAL SAVINGS ACCOUNTS AS

SHORT-TERM INVESTMENTS

2 to 90 days-or longer

- Small amounts welcome
- No brokerage fees
- No market risks—no fluctuations—no selling at a loss
- Withdraw anytime—no need to wait for maturities
- Invest and withdraw by mail, if you wish
- Safe—backed by The Bowery Savings Bank's record of 135 years of consecutive dividends.

The Bowery's Special Savings Account is intended for people who have cash standing idle for a few days ... weeks ... or months.

Dividends are paid on Special Accounts at the current rate of 4¾% yearly, compounded quarterly, from day of deposit to day of withdrawal if at least a $5 balance remains to the end of the quarter.

You may deposit up to $25,000 in an individual account ... $50,000 in a joint or trust account. Husband and wife may deposit as much as $100,000 in trust for each other.

Visit any Bowery Office to put your temporarily idle funds to work instantly ... phone (212) 697-1414 ... or send coupon.

What's happening is a process called disintermediation, or taking money out of the "intermediate" institutions and placing it in high-yielding paper. I include a chart (page 3) showing the rate of savings "growth" at the savings & loan associations (these institutions traditionally pay a higher rate than the savings banks). The chart is clear enough, the S & L's are losing money, and in July alone they lost $1 billion.

So where are the money-users going to go? The answer is— into the commercial paper market. I would watch for new highs for interest rates in commercial paper during the period ahead as company after company bids aggressively for this remaining source of cash outside the banking system. I want to dramatize this whole picture, and I enclose a little clip from the September 5 Wall Street Journal which gives a hit of the coming commercial paper rush. In my opinion, commercial paper during a squeeze (i.e., a flooding of the short-term money markets) could go to the 10-12% area, pushing 91-day Treasury bills up into the 8% yield area. And with it all will go a squeeze on corporate profits and new peaks of corporate illiquidity. There is only one remedy— a business slowdown and a liquidation of debt. That, as I see it, is what is coming up, and that is what the stock market is protecting itself against.

WORLD-WIDE: I think it is most important that my subscribers assume an international view of what is occurring. I have written much in this letter about interest rates and the monetary squeeze. Somehow, people have the idea that the U.S. is operating in a vacuum, and that all the Federal Reserve Board has to

Two More Concerns Sell Their Own Trade Paper

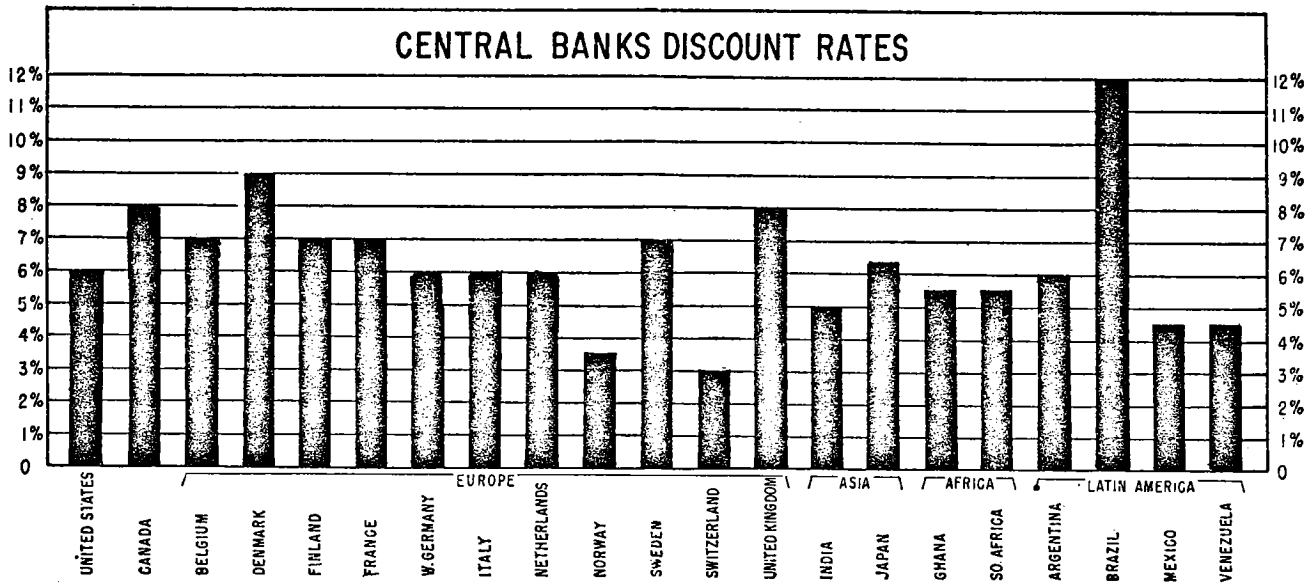
A WALL STREET JOURNAL *News Roundup*

Two more companies said they are selling their own commercial paper to tap another source for their financial needs.

McDonnell Douglas Finance Corp., the financing arm of McDonnell Douglas Corp., St. Louis, said in Long Beach, Calif., it has sold $15 million of notes.

In San Francisco, Transamerica Corp. said it sold its first note, for $2 million, to Yale University. The company said that its financial subsidiary, Transamerica Financial Corp., has for "many years" offered its promissory notes directly to lenders. Never before, however, had the parent taken this financing route. "We consider it prudent to employ this cost-saving method of financing," said Blair C. Pascoe, treasurer of the parent company.

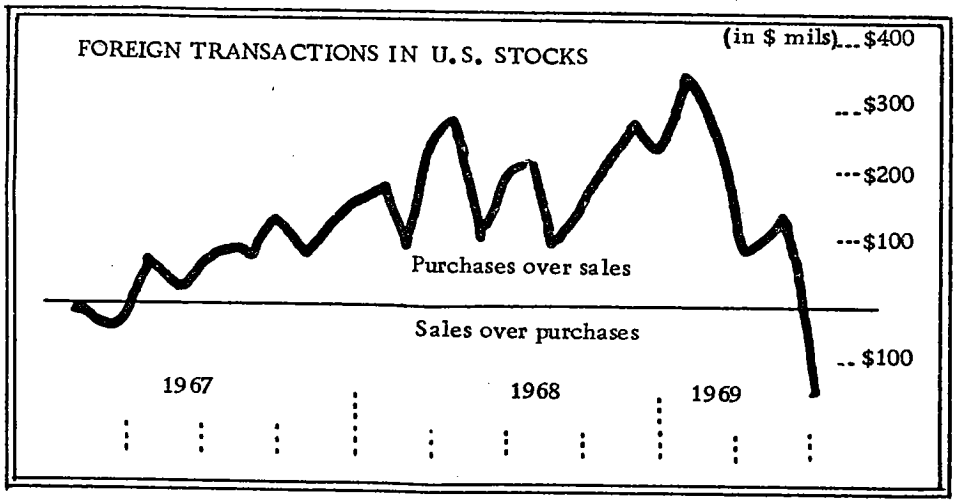
Last month, Gulf & Western Industries Inc. announced it also had begun selling notes directly to investors.



do to "boom" the economy is to lower the discount rate. It's hardly that simple.

There's a major problem. All over the Free World nations are locked in a death struggle with inflation. I have included a chart showing 21 discount rates throughout the world. Each month this chart shows new rate boosts. The latest was the German rise to 6%, following an Austrian rise two days earlier to 4.75% and a Japanese rise from 5.84% to 6.25%. Since the German boost will not only tend to halt inflation in Germany but will also have the effect of keeping money in Germany, the rate rise would hardly seem to suggest that Germany is ready to re-value the mark (as is so fervently hoped in the U.S. and Britain). The fact is that central banks are fighting a massive battle to hold on to their reserves, and the temperature of the battle can be measured in terms of central bank rates. As this is written, the temperature of the battle is still rising.

Meanwhile, a new forces is pressing against our security markets, a force which stems in some degree from fat interest rates (such as the 11.5% rate on Eurodollars) throughout the world. Why should a foreigner hold money in U.S. stocks which have not acted well when he can sell and place the proceeds in Eurodollars which earn him 11.5% a year? The answer is that foreigners have begun changing their minds about the U.S. market; consequently another adverse force on the U.S. balance-of-payments is building up. Note the chart showing the flow of money into and out of U.S. stocks from foreigners. The favorable trend of 1967 and 1968 has changed in 1969. Foreigners are now selling U.S. stocks on balance, and I believe that this trend will continue.



ECONOMIC SCRAPBOOK:

Sept. 4.....Consumer credit was up $622 million in July, but the rate of increase was the lowest since March, 1968. Capital spending plans by business continue to be trimmed. Latest polls show a 10.8% increase over 1968, rather than the earlier 12.6%.

Auto sales in the last third of August continued to slump, down 8.2%.

Domestic copper price is increased 4¢ to a record 52¢ a pound.

Sept. 5.....President Nixon ordered a 75% cut in new Federal construction contracts.
Long Island Lighting came out with an Aa-rated bond (maturity 1999) which yielded a record 8.20% to investors.

Sept. 8.....The D-J Municipal bond index went to another record yield high of 6.31%.
Central bankers confer in Basis to deal with a possible monetary crisis in the weeks ahead.

Sept. 9.....GE raises appliance prices an average of 3%.
Kennecott raises its copper prices to 52.5¢ per pound.
Price increases spread in the chemical and abrasives industries.

Sept. 10.....Bell Tel. system sold $150 million in bonds to yield 8.14%, the first time in history a Bell division had to pay over 8% in yield for a bond sale.
U.S. Steel raised prices on weld pipe for the second time this year.

Sept. 11.....GM announces price increases for new cars averages $125 per unit.

Sept. 12.....Germany raises the bank rate to 6%, highest in 18 years.

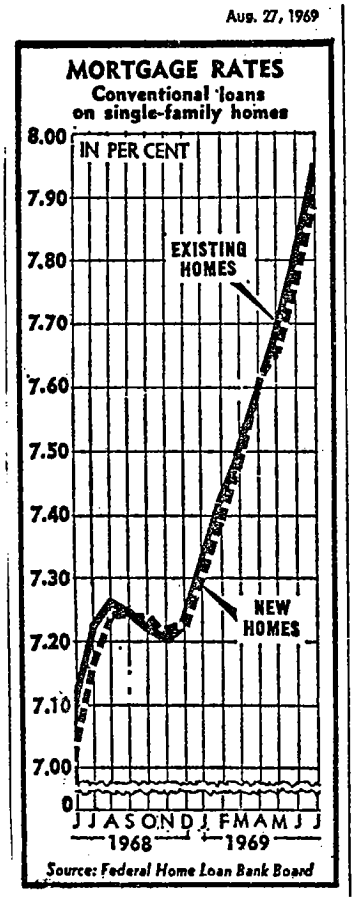


CHART OF THE WEEK: This chart shows the fantastic rates which buyers must now face when buying houses. These rates do not include extra points charged by the banks and savings and loans for closing fees, etc. With construction costs going up 1% a month and average mortgage rates in July at 7.9%, the buyer better beware.

NOTE: The writer has not taken any sort of vacation since these Letters were started in 1958. I am going to escape alone to the mountains Southeast of San Diego and about 10 miles from the isolated little town of Tecate, Mexico. Here I intend to think, away from the problems and vexations of civilization. I will be away about three or four days, and I will therefore extend the period of the publication of the next Letter. I expect to date the next Letter October 1. Until then, goodby to plushy lawns, goodby to boardrooms, goodby to big cars and worried faces. See you soon.

FINAL NOTE: The gold stock average last week broke a downward trendline which started from the March, 1969 high and lasted until September. I would guess that the lows for the gold shares were seen in August and that following a bit more base building, these stocks will be heading upward again. I feel that golds are now in another buying range with little real risk on the downside.